TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1914 1915

No. 393

TYEE REALTY COMPANY, PLAINTIFF IN ERROR,

vs.

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

FILED MARCH 12, 1915.

(24,612)

(24,612)

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1914.

No. 868.

TYEE REALTY COMPANY, PLAINTIFF IN ERROR,

vs.

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE.

IN ERROR TO THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

INDEX.

	Original.	Print
Writ of error	1	1
Clerk's certificate	2	1
Summons	4	2
Affidavit of service of summons and complaint	5	2
Complaint	6	3
Demurrer to complaint	14	7
Notice of motion for judgment	16	8
Order sustaining demurrer	17	9
Judgment	18	10
Petition for writ of error	19	10
Order allowing writ of error	20	11
Assignments of error	21	11
Bond on writ of error	24	13
Citation and service	27	15
Stipulation as to record	29	16

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MARCH 23, 1915.

1

B. T.

UNITED STATES OF AMERICA, *ss*:

The President of the United States of America to the Judges of the District Court of the United States for the Southern District of New York, Greeting:

Because in the records and proceedings and also in the rendition of the judgment of a plea which is in the said District Court before you between Tyee Realty Company, plaintiff, and Charles W. Anderson, defendant, a manifest error has happened to the great damage of the said Tyee Realty Company as by its complaint appears. We being willing that the error, if any has been, should be duly corrected and full and speedy justice done to the parties aforesaid in this behalf, do command you if judgment be therein given that under your seal distinctly and openly you send the record and proceedings aforesaid, with all things concerning the same, to the Supreme Court of the United States together with this writ so that you may have the same at the City of Washington on the 23rd day of March 1915 in the said Supreme Court to be then and there held that the record and proceedings aforesaid being inspected the said Supreme Court may cause further to be done to correct that error what of right and according to the laws and customs of the United States should be done.

Witness the Honorable Edward D. White, Chief Justice of the United States, the 24th day of February, in the year of our Lord One thousand nine hundred and fifteen and of the independence of the United States of America the one hundred thirty-ninth.

ALEX. GILCHRIST, JR.,
Clerk of the District Court of the United States
for the Southern District of New York.

Allowed by
J. M. MAYER,
District Judge.

2 UNITED STATES OF AMERICA,
Southern District of New York, ss:

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America, for the Southern District of New York, in the Second Circuit, by virtue of the foregoing Writ of Error, and in obedience thereto, do hereby certify, that the following pages numbered from four to 29 inclusive, contain a true and complete transcript of the record and proceedings had in said Court in the cause of Tyee Realty Company, Plaintiff in Error, against Charles W. Anderson, Defendant in Error, as the same remain of record and on file in said office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District

of New York, in the Second Circuit, this 11th day of March, in the year of our Lord one thousand nine hundred and fifteen, and of the Independence of the United States the one hundred and thirty-ninth.

[Seal District Court of the United States, Southern District of N. Y.]

ALEX. GILCHRIST, JR., *Clerk.*

3 [Endorsed:] L13—194. Dist. Court of the U. S., Southern Dist. of N. Y. Tyee Realty Company, Plaintiff, against Charles W. Anderson, Defendant. Original. Writ of Error. Davies, Auerbach & Cornell, Attorneys for Plaintiff, Mutual Life Building, 34 Nassau Street, New York City. U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915. 1.10. K.

4 United States District Court for the Southern District of New York.

TYEE REALTY COMPANY
against
CHARLES W. ANDERSON.

To the above-named Defendant:

You are hereby summoned to answer the complaint in this action, and to serve a copy of your answer on the plaintiff's attorney within twenty days after the service of this summons, exclusive of the day of service; and in case of your failure to appear, or answer, judgment will be taken against you by default for the relief demanded in the complaint.

Witness, the Hon. Charles M. Hough, Judge of the District Court of the United States for the Southern District of New York, at the City of New York, this 10th day of November in the year one thousand nine hundred and fourteen.

ALEX. GILCHRIST, JR., *Clerk.*
DAVIES, AUERBACH & CORNELL,
Plaintiff's Attorneys.

Office and Post Office Address, 34 Nassau St., Borough of Manhattan, New York City.

5 Office Copy.

United States District Court, Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

Affidavit of Service of Summons and Complaint.

STATE AND COUNTY OF NEW YORK, *ss:*

Jesse C. Millard, being duly sworn, says, that he is over twenty-one years of age, And that on the 14th day of November, 1914, at

the United States Customs House, Borough of Manhattan, City, County & State of New York he served the summons and complaint in this section, hereto annexed, upon Charles W. Anderson defendant in this action, by delivering a true copy of said summons and complaint to such defendant personally, and leaving the same with him. He further says, that he knew the person served as aforesaid to be the person mentioned and described in the said summons as the defendant in this action.

JESSE C. MILLARD.

New York County Register's No. 6003. *Commission Expires March* 30, 1916.

Sworn to before me, this 16th day of November 1914.

[Seal Frank C. Titus, Notary Public, New York County.]

FRANK C. TITUS,
Notary Public, New York County, No. 3846.

6 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

Complaint.

The plaintiff Tyee Realty Company, by Davies, Auerbach & Cornell, its attorneys, complaining of the defendant, respectfully shows:

First. The Plaintiff is a corporation duly organized and existing under and pursuant to the laws of the State of New York, having its principal place of business at No. 19 Cedar Street, in the Borough of Manhattan, City of New York, in the Southern District of New York, and in the Second Collection District of said State.

Second. The defendant is the Collector of Internal Revenue for the Second Collection District of the State of New York.

Tird. The business for which the plaintiff was organized and the only business which the plaintiff has ever conducted is the holding for investment of real property in the State of New York. The plaintiff was incorporated on the 10th day of April, 1906, under the Business Corporations Law of the State of New York, with an authorized capital stock of $10,000, all of which has been fully paid and duly issued. It purchased certain real property in the City of New York, subject to an indebtedness secured by mortgage.

7 amounting to $150,000, which was increased in 1908 to $200,000 and in 1911 to $275,000. On the 7th day of October, 1913, $5,000 of this indebtedness was paid off, leaving the total indebtedness of the plaintiff outstanding on December 31, 1913, $270,000.

The capitalization of the plaintiff mainly by means of mortgage indebtedness was in accordance with the public policy of the State of New York, as expressed in its Tax Laws, which laws are so framed as to encourage in the case of realty corporations the capitalization of the enterprise by a large amount of mortgage bonds and a relatively small capital stock. The tax upon mortgage indebtedness is permitted to be paid and in the case of your petitioner has been wholly paid, once for all by means of a recording tax, at the rate of one-half of one per centum of the principal of the mortgage debt, in consideration of which the said debt and the bonds or other instruments representing the same are exempt from taxation so long as the mortgage or any extension thereof continues in force. The annual taxation upon this form of capitalization, therefore, may be taken to be equal to the legal interest upon the amount paid as a recording tax, or three-tenths of a mill upon each dollar of the principal debt. The annual tax upon capital stock required to be paid to the State Comptroller is three-quarters of a mill upon each dollar of the capital stock.

The laws of New York are also so framed as to encourage in the formation of corporations such as the plaintiff a small nom-
8 inal capital stock as compared with the actual value of the property used by the corporation, because the organization tax is proportioned to the par value of the capital stock and not to its actual value. Furthermore, the laws of New York in respect to the general property tax, which in the case of corporations is called a tax on capital stock and surplus, are so framed as to encourage and favor the method of capitalization adopted by the plaintiff, in that by such laws the plaintiff is authorized to deduct from the aggregate value of its property not only the assessed valuation of its real estate, but also the outstanding indebtedness secured by mortgage upon its real estate.

The above mentioned provisions of the laws of New York form part of a system of taxation deliberately adopted as the result of many years of experimentation and discussion, whereby direct taxes for State purposes have been practically eliminated and the jealousies, controversies and recriminations which formerly existed between different sections of the State, on account of alleged inequalities in respect to direct taxation, have been eliminated. In addition, by the system of taxation above referred to, the formation under the laws of New York of corporations designed to do business in that State, as distinguished from the organization of such corporations under the laws of other States, has been promoted, the issuance by real estate corporations of large volumes of stock for speculative purposes has been discouraged and the interests of the people of the State of New York in respect to matters wholly within the jurisdiction and control of their State government have been safe-
9 guarded in many other ways according to the best judgment of those who have from time to time been charged with the duty of determining the legislative policy of the State.

Fourth. On or about the 21st day of May, 1914, under the alleged authority of Section 38 of the Act of Congress approved August 5,

1909, entitled "An Act to provide Revenue, Equalize Duties, Encourage the Industries of the United States and for other Purposes" and of Section 2 of the Act of Congress approved October 3, 1913, entitled "An Act to Reduce Tariff Duties and to Provide Revenue for the Government and for Other Purposes", there was assessed upon the plaintiff by the Commissioner of Internal Revenue a tax of Seventy and 64/100 Dollars ($70.64), and thereafter notice of such assessment was duly given to the petitioner and a demand made upon the petitioner by the defendant for the payment of said tax on or before the 30th day of June, 1914, at the United States Customs House Building in the City of New York, in order to avoid penalty and interest. On or about the 15th day of July, 1914, a further notice and demand for payment of said tax was served upon the plaintiff by the defendant accompanied by a threat to distrain the property of the plaintiff if said tax was not paid within ten days. Thereafter and on or about the 21st day of July, 1914, the plaintiff paid to the defendant under protest and under duress, said sum of Seventy and 64/100 Dollars ($70.64).

Fifth. Thereafter and on or about the 24th day of July, 1914, the plaintiff duly appealed to the Commissioner of Internal Rev-
10 enue against the assessment and collection of said tax and demanded repayment of the amount so collected upon the ground that the said tax was erroneously and illegally assessed and collected for the reasons specified in its petition of appeal, and thereupon the said Commissioner overruled and denied the said appeal in all respects.

Sixth. The tax collected by the defendant from the plaintiff, as above described, was erroneously and illegally assessed and collected particularly in the following respects:

(1) Section 2 of said Act of Congress approved October 3, 1913, is unconstitutional and void because it is not a due exercise of the taxing power conferred by the Constitution upon Congress, because it involves the taking of property without due process of law and the taking of property for public use without compensation and because the classifications, discriminations and inequalities contained in said Act are arbitrary and have no reasonable relation to the production of revenue for the purposes of government, but are intended solely to regulate the conduct and affairs of the citizens and residents of the United States in respect to matters which are not within the powers delegated to Congress by the Constitution.

(2) Section 2 of the said Act approved October 3, 1913, insofar as it purports to tax the plaintiff and other corporations similarly situated not upon their actual net income, but upon a fictitious net income created for the purpose of taxation only by the application of artificial rules of computation, is not designed for the production of revenue, but is designed to regulate the internal affairs of such corporations in respect to the plan or method of capitaliza-
11 tion, and it thus involves an arbitrary classification of the persons subject to the tax having no reasonable relation to any power conferred upon Congress by the Constitution. In respect to

the application of the above-mentioned provisions of Section 2 to the affairs of the plaintiff, it is respectfully shown:

(*a*) The plaintiff paid in the year 1913 as interest upon its mortgage debt the sum of $13,750.00. The actual net income of the plaintiff for the year ending December 31, 1913, after deducting the interest actually paid upon its mortgage debt, its taxes and other expenses, was $564.26, upon which the normal tax of one per cent. would amount to $5.64. The tax actually exacted from the plaintiff under the terms of said Act of October 3, 1913, amounts to $70.64, being about twelve and one-half times the tax to which the plaintiff would have been subject if it had adopted the method or plan of capitalization which it was the obvious intention of Congress in enacting said Act of October 3, 1913, to make compulsory. The difference, $65.00, is in the nature of a penalty imposed upon the plaintiff for the year 1913 because its plan and method of capitalization were such as the laws of New York not only permit but actually favor and encourage. Moreover, this penalty is imposed by an ex post facto law, because the plaintiff could not anticipate prior to October 3, 1913, what the provisions of said Act would be in regard to regulating the capitalization of corporations and the greater part of said tax and penalty is imposed upon the plaintiff in respect to its supposed income prior to October 3, 1913.

12 (*b*) The actual value of the capital stock of the plaintiff for the year 1913 was assessed by the Comptroller of the State of New York at $57,300 and the plaintiff was taxed thereon accordingly. Had the nominal par value of the plaintiff's capital stock been equal to its actual value in said year, as so assessed, it would have been entitled in the computation of its taxable income to a deduction on account of interest amounting to $9,615 instead of the deduction of $7,250, which was all that was allowed to it under the terms of said Act of October 3, 1913, exacted from the plaintiff and the tax would have been only $46.99, instead of $70.64. The difference, $23.65, is in the nature of a penalty imposed upon the plaintiff because the nominal or par value of its capital stock is less than the actual value, although such method of capitalization is not only permitted but actually encouraged by the laws of the State of New York, which State alone possesses the right to regulate the organization and capitalization of the plaintiff.

(3) Section 2 of the said Act approved October 3, 1913, is not based upon any census or an enumeration made as required by the Constitution and is dependent for its validity upon the express authority given by the Sixteenth Amendment to the Constitution of the United States in relation to the taxation of income as such. The tax assessed against the plaintiff as aforesaid did not purport to be based upon any income received or accrued after the approval of said Act, but purported to be and in fact was based upon

13 the amount shown by the return of the plaintiff as its net income for the entire year ending December 31, 1913, of which said net income a large amount actually accrued to and was received by the plaintiff prior to October 3, 1913. At the time of the assessment of said tax there was no competent evidence before

the Commissioner of Internal Revenue that any income had accrued to or had been received by the plaintiff on or subsequent to October 3, 1913.

Wherefore, the plaintiff demands judgment against the defendant in the sum of Seventy and 64/100 dollars ($70.64), with interest from the 21st day of July, 1914, and the costs of this action.

DAVIES, AUERBACH & CORNELL,
Attorneys for Plaintiff.

Office & Post-Office Address: 34 Nassau Street, Borough of Manhattan, New York City.

STATE OF NEW YORK,
City and County of New York, ss:

Edwin Thorne, being duly sworn, deposes and says that he is the President of the Tyee Realty Company, the plaintiff above named; that he has read the foregoing complaint and knows the contents thereof; that the same is true of his own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

EDWIN THORNE.

Sworn to before me, this 9th day of November, 1914.

SAMUEL THORNE, JR.,
Notary Public, Westchester County.

Certificate filed in New York County.
Term expires March, 1916.

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Nov. 16, 1914.

14

11362.

United States District Court, Southern District of New York.

L. 13/194.

TYEE REALTY COMPANY, Plaintiff,
v.
CHARLES W. ANDERSON, Defendant.

Demurrer to Complaint.

The defendant demurs to the complaint herein on the ground that, as appears upon the face thereof, it does not state facts sufficient to constitute a cause of action.

Dated: New York, February 2, 1915.

H. SNOWDEN MARSHALL,
United States Attorney,
Attorney for Defendant.

Office & Post Office address: U. S. Courts & P. O. Building, Borough of Manhattan, City of New York.

15 CITY OF NEW YORK,
County of New York, ss.:
State of New York,

Ben A. Matthews, being duly sworn, deposes and says that he is an Assistant United States Attorney for the Southern District of New York and as such has charge of the above-entitled case; that the above demurrer is not interposed for the purpose of delay, and that he verily believes that the complaint herein is bad in law.

BEN A. MATTHEWS.

Sworn to before me this 2nd day of February, 1915.

[SEAL.] FREDERICK D. CAMPBELL,
Notary Public, Kings County, No. 187.

Certificate Filed in New York County.
No. 61, New York County.
Register's No. 5164, New York County.
Register's No. 6178, Kings County.
My Commission Expires March 30, 1915.

(Endorsed:) Due service of a copy of the within is hereby admitted. New York, February 4, 1915. Davies, Auerbach & Cornell, Attorneys for Plaintiff.—U. S. District Court, S. D. of N. Y., Filed Feb. 5, 1915.

16 *Notice of Motion for Judgment.*

United States District Court, Southern District of New York.

L. 13—194.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

SIR: Please take notice that on the complaint in the above entitled action and the demurrer interposed thereto, the undersigned will move this court at a stated term thereof, for the hearing of motions on the 11th day of February, 1915, at 10:30 o'clock in the forenoon of said day at the Post-office Building, Borough of Manhattan, City of New York, or as soon thereafter as counsel can be heard for judgment upon the pleadings herein and for such other and further relief as to the court may seem just and proper.

Yours, etc.,
DAVIES, AUERBACH & CORNELL,
Attorneys for the Plaintiff.

34 Nassau Street, New York City.

To H. Snowden Marshall, Esq., United States Dist. Attorney and Attorney for the Defendant, Post Office Building, Borough of Manhattan, New York City.

(Endorsed:) Copy Received. Feb. 6, 1915. H. Snowden Marshall, U. S. Attorney.—U. S. District Court, S. D. of N. Y., Filed Feb. 15, 1915.

17 At a Stated Term of the District Court of the United States of America for the Southern District of New York, Held at the United States Court Rooms, in the Borough of Manhattan, City of New York, on the 11th Day of February, 1915.

Present: Hon. Julius M. Mayer, Judge.

L. 13/194.

TYEE REALTY COMPANY, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

Order Sustaining Demurrer.

This cause having come on before me upon demurrer filed by the defendant to the complaint herein, and after hearing Ben A. Matthews, Assistant United States Attorney, in support of said demurrer, and Brainard Tolles in opposition thereto, and after due deliberation;

Now, upon motion of H. Snowden Marshall, United States Attorney, to sustain the demurrer and dismiss the complaint herein upon the ground that section 2 of the Act of Congress approved October 3, 1913, is in all respects constitutional and valid, it is

Ordered that the said demurrer be and the same hereby is in all respects sustained; and it is

Further ordered that the complaint herein be and the same hereby is dismissed; and it is

Further ordered that judgment on the merits be entered for defendant with costs.

J. M. MAYER,
U. S. District Judge.

Notice of Settlement waived.
Consented to as to form.
DAVIES, AUERBACH & CORNELL,
Att'ys for Plaintiff.

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 15, 1915.

18 *Judgment.*

United States District Court, Southern District of New York.

L. 12/194.

TYEE REALTY COMPANY, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

This cause having come on for hearing before the Honorable Julius M. Mayer, District Judge, upon the demurrer filed by the defendant to the complaint herein at a stated term held on the 11th day of February, 1915, and Ben A. Matthews, Esq., Assistant United States Attorney, appearing in support of said demurrer, and Brainard Tolles, Esq., in opposition thereto; and due deliberation having been had thereon and an order having been entered on the 15th day of February, 1915, wherein it was ordered that the complaint be dismissed with costs, and the costs having been taxed at the sum of Eighteen & 70/100 Dollars;

Now on motion of H. Snowden Marshall, Esq., United States Attorney for the Southern District of New York, attorney for defendant, it is adjudged that the defendant, Charles W. Anderson, herein, have judgment against the plaintiff, Tyee Realty Company, on the merits and that the defendant recover of the plaintiff the sum of Eighteen & 70/100 Dollars; and that defendant have execution therefor.

Judgment signed this 18th day of February, 1915.

ALEX. GILCHRIST, JR.,
Clerk U. S. District Court.

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 18, 1915, 4:00 P. M.

19 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

Petition for Writ of Error.

To the Honorable Judges of the District Court of the United States for the Southern District of New York:

The petition of Tyee Realty Company, the plaintiff herein, respectfully shows that on or about the 18th day of February, A. D., 1915, judgment was duly entered in this court in this cause in favor of the defendant and against the plaintiff dismissing the complaint,

in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this plaintiff, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore, this plaintiff prays that a writ of error may issue in this behalf out of the Supreme Court of the United States for the correction of the errors so complained of and that a transcript of the record, proceedings and papers in this cause duly authenticated may be sent to the Supreme Court of the United States.

DAVIES, AUERBACH & CORNELL,
Attorneys for Plaintiff.

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 24, 1915.

20 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

Order Allowing Writ of Error.

This 24th day of February, A. D., 1915, comes the plaintiff, by its attorney, and files herein and presents to the court its petition praying for the allowance of a writ of error and assignment of errors intended to be urged by it, praying also that a transcript of the record, proceedings and papers upon which the judgment herein was rendered, duly authenticated, may be sent to the Supreme Court of the United States and that such other and further proceedings may be had as are proper in the premises.

On consideration whereof the court does allow the writ of error upon the plaintiff's giving bond according to law in the sum of $250, which shall operate as a supersedeas bond.

J. M. MAYER, *D. J.*

(Endorsed:) U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915.

21 In the District Court of the United States for the Southern District of New York.

TYEE REALTY COMPANY, Plaintiff,
against
CHARLES W. ANDERSON, Defendant.

Assignment of Errors.

Now comes the plaintiff, Tyee Realty Company, and assigns errors in the trial and decision of this cause as follows:

First. The court erred in sustaining the demurrer of the defendant to the complaint herein.

Second. The court erred in holding that the complaint herein did not state facts sufficient to constitute a cause of action.

Third. The court erred in holding that Section 2 of the Act of Congress approved October 3rd, 1913, entitled "An Act to reduce tariff duties and to provide revenue for the government and for other purposes" is in all respects constitutional and valid.

Fourth. The court erred in holding that Section 2 of said Act of Congress approved October 3, 1913, is an exercise of the power conferred upon Congress by the Sixteenth Amendment to the Constitution to tax incomes from whatever source derived.

Fifth. The court erred in holding that Section 2 of the
22 said Act approved October 3, 1913, insofar as it purports to tax this plaintiff and other corporations similarly situated not upon their actual net income, but upon a fictitious net income created for the purpose of taxation only by the application of artificial rules of computation, is constitutional and valid.

Sixth. The court erred in holding that Section 2 of the said Act approved October 3, 1913, insofar as it attempts to regulate the internal affairs of corporations organized under the laws of the several States in respect to their plan or method of capitalization, is constitutional and valid.

Seventh. The court erred in holding that Section 2 of the said Act approved October 3, 1913, insofar as it imposes a penalty through disproportionate taxation upon this plaintiff because the nominal or face value of its capital stock is small in proportion to its mortgage debt, is constitutional and valid.

Eighth. The court erred in holding that Section 2 of the said Act approved October 3, 1913, insofar as it imposes a penalty upon this plaintiff through disproportionate taxation because the nominal or face value of its capital stock is small compared with the real value of its net assets, is constitutional and valid.

Ninth. The court erred in holding that Section 2 of said Act approved October 3, 1913, insofar as it purports to tax the income of the plaintiff received and expended or merged in the general assets of the plaintiff prior to the passage of said Act, is constitutional and valid.

Tenth. The court erred in dismissing the complaint and
23 in directing judgment in favor of the defendant upon the merits with costs.

Wherefore, plaintiff prays that the judgment of the said District Court may be reversed.

DAVIES, AUERBACH & CORNELL,
Attorneys for Plaintiff.

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Feb. 24, 1915.

24 Know all men by these presents, that we, Tyee Realty Company, as principal, and National Surety Company, as surety, are held and firmly bound unto Charles W. Anderson in the full and just sum of Two Hundred Fifty Dollars ($250), to be paid to the said Charles W. Anderson, his attorneys, executors, administrators or assigns; for which payment well and true to be made we bind ourselves, our heirs, executors, administrators and legal representatives jointly and severally by these presents.

Sealed with our seals this 23rd day of February in the year of our Lord One thousand nine hundred and fifteen.

Whereas, lately in the District Court of the United States for the Southern District of New York, in a suit depending in said court between Tyee Realty Company, plaintiff, and Charles W. Anderson, defendant, a judgment was rendered against the said Tyee Realty Company and said Tyee Realty Company having obtained a writ of error and filed a copy thereof in the Clerk's office of the said court to review the judgment in the aforesaid suit, and a citation having issued directed to the said Charles W. Anderson citing and admonishing him to be and appear at a session of the Supreme Court of the United States to be holden at the City of Washington on the — day of — next.

Now, the condition of the above obligation is such that if the said Tyee Realty Company shall prosecute said writ of error to effect and answer all damages and costs, if it fail to make its plea good, then the above obligation to be void, else to remain in full force and effect.

Sealed and delivered in the presence of:

[CORPORATE SEAL.] NATIONAL SURETY COMPANY,
By WM. A. THOMPSON,
Resident Vice President.

Approved by:

——— ———,
U. S. District Judge.

Attest:
N. V. TYNAN,
Resident Ass't Secretary.

25 TYEE REALTY COMPANY,
By JOHN N. GOLDING, *President.*

Attest:
THEO. G. BECKER,
[SEAL.] *Secretary.*

STATE OF NEW YORK,
County of New York,
Southern District of New York, ss:

On the 1st day of March, in the year One thousand nine hundred and fifteen, before me personally came John N. Golding, to me known, who, being by me duly sworn, did depose and say, that he

resides in The Borough of Manhattan, City of New York; that he is the President of the Tyee Realty Company, the corporation described in and which executed the above instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by the like order.

[NOTARIAL SEAL.] FRANK C. TITUS,
Notary Public, New York County, No. 3846.

3

New York County Register's No. 6003.
Commission Expires March 30, 1916.

Approved by:
C. M. HOUGH,
U. S. District Judge.

26 Capital $2,000,000.00.

Affidavit, Acknowledgment, and Justification by Guarantee or Surety Company.

STATE OF NEW YORK,
County of New York, ss:

On this 23rd day of February one thousand nine hundred and fifteen before me personally came Wm. A. Thompson, known to me to be the Resident Vice-President of the National Surety Company, the corporation described in and which executed the within and foregoing Bond of Tyre Realty Company, as a surety thereon, and who, being by me duly sworn, did depose and say that he resides in the City of New York, State of New York; that he is the Resident Vice-President of said Company, and knows the corporate seal thereof; that the said National Surety Company, is duly and legally incorporated under the laws of the State of New York; that said Company has complied with the provisions of the Act of Congress of August 13th, 1894; that the seal affixed to the within Bond of Tyre Realty Company, is the corporate seal of said National Surety Company, and was thereto affixed by order and authority of the Board of Directors of said Company; that he signed his name thereto by like order and authority as Resident Vice-President of said Company; that he is acquainted with N. V. Tynan and knows him to be the Resident Assistant Secretary of said Company; that the signature of said N. V. Tynan subscribed to said Bond is in the genuine handwriting of said N. V. Tynan, and was thereto subscribed by order and authority of said Board of Directors, and in the presence of said deponent; that the assets of said Company, unencumbered and liable to execution exceed its debts and liabilities of every nature whatsoever, by more than the sum of Two Million ($2,000,000) dollars.

That — is agent to acknowledge service for said Company in the Judicial District wherein this bond is given.

[CORPORATE SEAL.] WM. A. THOMPSON.
(Deponent's Signature.)

Sworn to, acknowledged before me, and subscribed in my presence this 23rd day of February, 1915.

[NOTARIAL SEAL.] H. E. EMMETT,
(Officer's Signature, Description, and Seal.)
Notary Public for Kings County, No. 3.

Certificate filed in New York County, No. 2, Nassau, Bronx, Queens, Richmond and Westchester Counties.
Kings County Register's Office No. 6802.
New York County Register's Office No. 6617.
Bronx County Register's Office No. 608.

(Endorsed:) U. S. District Court, S. D. of N. Y., Filed Mar. 2, 1915.

27 B. T.

UNITED STATES OF AMERICA, *ss*:

To Charles W. Anderson, Greeting:

You are hereby cited and admonished to be and appear at the Supreme Court of the United States to be holden at the City of Washington on the 23rd day of March next, pursuant to a writ of error filed in the Clerk's office of the District Court of the United States for the Southern District of New York, wherein Tyee Realty Company is plaintiff and you are defendant in error, to show cause, if any there be, why the judgment rendered against the said plaintiff in error as in said writ of error mentioned should not be corrected and speedy justice be done to the parties in that behalf.

Given under my hand at the City of New York in the district above named this 24th day of February, in the year of our Lord One thousand nine hundred and fifteen.

J. M. MAYER,
Judge of the District Court of the United States for the Southern District of New York.

A. G., JR.

28 [Endorsed:] A copy of the within paper has been this day received at this office, Feb. 23, 1915. H. Snowden Marshall, U. S. Attorney. Service of a copy of the within citation is hereby admitted this 24th day of February, 1915. ————, United States District Attorney and Attorney for Defendant in Error. L. 13—194. Dist. Court of the U. S., Southern Dist. of N. Y. Tyee Realty Company, Plaintiff, against Charles W. Anderson, Defendant. (Original.) Citation. Davies, Auerbach & Cornell, Attorneys for Plaintiff Mutual Life Building, 34 Nassau Street, New York City. U. S. District Court, S. D. of N. Y. Filed Feb. 24, 1915. .10. K.

29 United States District Court, Southern District of New York.

L. 13—194.

TYEE REALTY COMPANY, Plaintiff,
vs.
CHARLES W. ANDERSON, Defendant.

It is hereby stipulated and agreed that the Record on Appeal in the above entitled action to the Supreme Court of the United States shall consist of the following papers, to wit:

Summons
Affidavit of Service of Summons
Complaint
Demurrer to Complaint
Notice of Motion for Judgment
Order sustaining demurrer
Judgment
Petition for Writ of Error
Assignment of Errors
Bond on Appeal
Order allowing Writ of Error
Writ of Error
Citation

and may be so certified by the Clerk of the United States District Court for this District.

Dated March 2, 1915.

DAVIES, AUERBACH & CORNELL,
Attorneys for Plaintiff.
H. SNOWDEN MARSHALL,
U. S. Attorney,
Attorney for Defendant.

[Endorsed:] United States Supreme Court. Tyee Realty Company, Plaintiff in Error, ag'st Charles W. Anderson, Defendant in Error. Transcript of Record. Error to the District Court of the United States for the Southern District of New York.

Endorsed on cover: File No. 24,612. S. New York D. C. U. S. Term No. 868. Tyee Realty Company, plaintiff in error, vs. Charles W. Anderson, Collector of Internal Revenue. Filed March 12th, 1915. File No. 24,612.

9

Supreme Court of the United States,

OCTOBER TERM, 1915.

No. 393.

TYEE REALTY COMPANY,
Plaintiff-in-Error,

against

CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE,
Defendant-in-Error.

BRIEF FOR PLAINTIFF-IN-ERROR.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Walter A. Schmidt

Of Counsel.

The Evening Post Job Printing Office, Inc., 156 Fulton St., N. Y.

INDEX.

PAGE

Introduction 1

Statement of Facts 2

Specification of Errors 6

POINT FIRST: The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the States in its application to a general and uniform tax upon incomes from whatever source derived. The Income Tax Law of 1913, except in so far as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.... 8

POINT SECOND: So much of Section 2 of the Act of October 3d, 1913, as limits the interest which may be deducted in ascertaining the taxable income of a corporation to the interest accrued and paid within the year on an amount of indebtedness not exceeding one-half of the sum of its interest-bearing indebtedness and its paid-up capital stock, is invalid..... 8

(*a*) Concrete operation of the act on the affairs of the plaintiff..... 9

(*b*) The discrimination is unwarranted by the Sixteenth Amendment.... 10

(*c*) The tax does not rest upon income in the true sense of the word..... 11

(*d*) The classification is arbitrary and unreasonable..... 18

(*e*) Conclusion..... 30

PAGE

POINT THIRD: The statute is invalid in the particular of seeking to tax income received prior to October 3d, 1913, and the tax complained of is wholly void because based in part upon such income 31

POINT FOURTH: The judgment should be reversed and the demurrer overruled, with leave to the defendant to answer 33

TABLE OF CASES.

Andrews *v.* Boyd, 5 Me. 199 14

City of Kingston *v.* Canada Life Ass. Co., 19 Ont. 453 15
Colquhoun *v.* Brooks, L. R., 14 A. C. 493 16
County of Santa Clara *v.* Southern Pacific R. Co., 18 Fed. 385; 118 U. S. 394 25
County of San Mateo *v.* Southern Pacific R. Co., 13 Fed. 145 28

Lawless *v.* Sullivan, L. R., 6 App. Cas. 373 .. 14
Little Miami Railroad *v.* U. S., 108 U. S. 277 18
Loan Assn. *v* Topeka, 20 Wall. 655 20
Loughborough *v.* Blake, 5 Wheat. 317 20

McCulloch *v.* Maryland, 4 Wheat. 316 20
McCoach *v.* Minehill R. Co., 228 U. S. 295 ... 33
Maine *v.* Grand Trunk Ry. Co., 142 U. S. 217. 17

Northern Pacific R. Co. *v.* Walker, 47 Fed. 681 30

	PAGE
Peck *v.* Kinney, 143 Fed. 76	13
Pembina Mining Co. *v.* Pennsylvania, 125 U. S. 181	24
People *v.* Supervisors, 4 Hill, 20	17
Philadelphia S. S. Co. *v.* Pennsylvania, 122 U. S. 326	17
Poland *v.* Railroad Co., 52 Vt. 144	14
Pollock *v.* Farmers L. & T. Co., 157 U. S. 429	20
Railroad Company *v.* Collector, 100 U. S. 595.	17
San Bernardino Co. *v.* Southern Pacific R. Co., 118 U. S. 417	27
Scholey *v.* Rew, 23 Wall. 331	20
Southern Railway Co. *v.* Greene, 216 U. S. 400	23
State Tax on Railway Gross Receipts, 15 Wall. 284	17
Taxation Commissioners *v.* Antill, L. R. 1902; App. Cas. 422	16
Thompson *v.* Redding (1897), 1 Ch. 876	13
U. S. *v.* Erie R. R. Co., 166 U. S. 327	18
U. S. *v.* Singer, 15 Wall. 111	20
Ward *v.* Maryland, 12 Wall. 418	20
Zonne *v.* Minneapolis Syndicate, 220 U. S. 187	33

Supreme Court of the United States,

OCTOBER TERM, 1915.

TYEE REALTY COMPANY, Plaintiff in Error, vs. CHARLES W. ANDERSON, Collector of Internal Revenue, Defendant in Error.	No. 393.

BRIEF FOR APPELLANT.

This case comes before this Court upon a writ of error to the District Court of the United States, for the Southern District of New York. The Tyee Realty Company, the plaintiff in error, sued Charles W. Anderson, as Collector of Internal Revenue, in the District Court of the United States to recover the sum of $70.64, with interest from the 21st day of July, 1914, with costs, being the amount claimed to have been paid by the plaintiff to the defendant under protest and under duress, on the 21st day of July, 1914, as an alleged income tax assessed upon the plaintiff by the Commissioner of Internal Revenue for the period from March 1, 1913, until January 1, 1914.

The complaint was demurred to, and a motion was made to dismiss the complaint, and judgment was given to the defendant against the plaintiff in error upon the merits, together with the sum of

$18.70 as costs (Rec., fol. 18), whereupon the plaintiff in error sued out a writ of error, which was duly allowed (Rec., fol. 11), and duly assigned errors in the trial and decision of the cause (Rec., fol. 12).

Statement of Facts.

This case raises the question of the validity of so much of Section 2 of the Act of October 3d, 1913, as provides that in the taxation of a corporation there is to be deducted from its gross income, not the total amount of interest paid within the year upon its indebtedness which is allowed to be deducted in the case of an individual taxpayer, but only an amount of interest paid by the corporation on a sum equal to one-half of its indebtedness bearing interest augmented by the par value of its capital stock.

The complaint states that the plaintiff is a corporation organized under the laws of New York, with its principal place of business in New York City. The business for which it is organized, and the only business which it has ever conducted, is holding real property in the State of New York for investment. It was incorporated in 1906, under the Business Corporations Law of New York, with an authorized capital stock of $10,000, all of which is now outstanding and fully paid. It purchased certain real estate in New York City, subject to indebtedness secured by mortgage, amounting at first to $150,000, which was later increased to $275,000. Its total indebtedness outstanding on December 31, 1913, was $270,000, being all mortgage indebtedness as above stated, $5,000 of its indebtedness having been paid off on October 7, 1913. We have, then, the case of a New York corporation whose operations are entirely confined to New York and whose property is situated in New York, with an authorized capitali-

zation of $10,000, and a mortgage debt of $270,000 (Rec., p. 3).

The complaint explains the circumstances attendant upon this situation. The plaintiff, it states, was capitalized wholly by means of mortgage indebtedness. This, it alleges, was in accordance with the public policy of New York State as embraced in its tax laws. These laws are so framed as to encourage, in the case of real estate companies, the capitalization of the enterprise by a large amount of mortgage bonds and a relatively small capital stock. This is indicated by the following provisions of New York's tax laws:

(*a*) Mortgage indebtedness is taxed only once by means of a recording tax at the rate of one-half of one per cent. of the principal of the mortgage debt; and in consideration of the payment of this tax the mortgage debt is exempt from taxation thereafter so long as the mortgage or any extension thereof continues in force, leaving the annual tax upon this form of capitalization equal to the legal interes upon the amount paid as the recording tax, or .0003.

(*b*) The annual tax upon capital stock required to be paid by the State Comptroller is .003/4.

(*c*) The organization tax of New York is proportioned to the par value of the capital stock and not to its actual value.

(*d*) The tax in New York upon personal property is assessed upon its value after deducting therefrom all the taxpayer's outstanding indebtedness.

The complaint alleges that these provisions of the New York laws from part of a system of taxation adopted as a result of many years of experiment and discussion, whereby direct taxes for

state purposes have been practically eliminated, and equalization of taxation has been effected between all the different sections of the state. By this system of taxation, an inducement has been given to corporations designed to do business in New York, to organize themselves under the laws of that state, as distinguished from other states, and also the practice of real estate corporations of issuing large volumes of stock for speculative purposes has been discouraged. All of this has been the result of the best judgment of those who have from time to time been charged with the duty of determining the legislative policy of New York State (Rec., p. 4).

The complaint then states that under the present Income Tax Law the Commissioner of Internal Revenue assessed upon the plaintiff's alleged income for the ten months of 1913 a tax of seventy dollars and sixty-four cents ($70.64). Thereafter notice of such assessment was given to the plaintiff and a demand made upon it by the defendant for the payment of the tax on or before June 30, 1914, in order to avoid penalty and interest. A further notice having been served upon the plaintiff about July 15, 1914, accompanied by a threat to distrain the plaintiff's property if the tax were not paid within ten days, the plaintiff on July 21, 1914, paid the tax to the defendant under protest and duress. On July 24, 1914, the plaintiff appealed to the Commissioner of Internal Revenue against the assessment and collection of the tax, and demanded repayment of the same upon the ground that the tax was erroneously and illegally assessed and collected. The Commissioner denied this appeal. The plaintiff then alleges that this tax was erroneously and illegally assessed and collected, particularly in the respects then enumerated, which may be reduced to the following: The statute does not tax the plaintiff or any other corporation so situated upon its

real net income. On the contrary, it imposes the tax upon a fictitious net income created, for the purposes of taxation only, by the application of artificial rules of computation. In 1913 the plaintiff paid $13,750 as interest on its mortgage debt. Its actual net income for that year after deducting this interest, its taxes and other expenses, was $564.26. A normal tax of one per cent. upon the company's net income would be $5.64. The tax actually exacted from the plaintiff under the terms of the income tax law amounts to twelve and one-half times that figure. The difference, the bill alleges, is in the nature of a penalty imposed upon the plaintiff for the year 1913, because its plan and method of capitalization was such as the laws of New York not only permit, but actually favor and encourage. In addition, this penalty is imposed by an *ex post facto* law. Prior to the actual passage of the act, the plaintiff could not anticipate what its provisions would be in regard to regulating the capitalization of corporations. The greater part of this tax and penalty is imposed upon the plaintiff in respect to its supposed income prior to October 3, 1913. The complaint also alleges that the actual value of the plaintiff's capital stock for 1913 was assessed by the Comptroller of New York State at $57,300, and the plaintiff was taxed thereon accordingly. If the nominal par value of the plaintiff's capital stock had been equal to its actual value in that year as so assessed, it would have been entitled, in the computation of its taxable income, to a deduction on its income amounting to nine thousand six hundred fifteen dollars ($9,615) instead of the deduction of seven thousand two hundred and fifty dollars ($7,250), which was all that was allowed to it under the Income Tax Law, and the tax would have been only forty-six dollars and ninety-nine cents ($46.99) instead of seventy dollars and sixty-four cents ($70.64). The

difference of twenty-three dollars and sixty-five cents ($23.65) is in the nature of a penalty imposed upon the plaintiff because the par value of its capital stock is less than its actual value, although such method of capitalization is not only permitted, but actually encouraged by the laws of New York.

The complaint then alleges that the Income Tax Law depends for its validity on the Sixteenth Amendment to the Constitution, relating to the taxation of income as such. The tax assessed against the plaintiff did not purpose to be based on any income received or accrued after the passage of the act, but purported to be, and in fact was, based on the amount computed by the Commissioner as its taxable income for ten months of the year ending December 31, 1913, *of which income a large amount actually accrued to and was received by the plaintiff prior to October 3, 1913.* At the time the tax was assessed there was no competent evidence before the Commissioner of Internal Revenue that any income had accrued to the plaintiff or been received by it subsequent to October 3, 1913.

The complaint demands judgment for the return of the tax paid, with interest and costs.

Specification of Errors.

1. The Income Tax Law of 1913 in its application to the plaintiff in this case is not an exercise of the power conferred upon Congress by the Sixteenth Amendment to tax "incomes from whatever source derived."

2. The law purports to tax the plaintiff, not upon its actual net income, but upon a fictitious net income created for the purposes of taxation only by applying artificial rules of computation and by allowing plaintiff as a deduction from its gross

income, not the interest paid by it during the year, but only the interest paid upon one-half of its interest bearing indebtedness augmented by the par value of its capital stock.

3. The law attempts to regulate the internal affairs of corporations organized under the laws of the several States in respect to their plan or method of capitalization.

4. The law, through disproportionate taxation, imposes a penalty upon the plaintiff because the nominal or face value of its capital stock is small in proportion to its mortgage debt.

5. The law, through disproportionate taxation, imposes a penalty upon the plaintiff because the nominal or face value of its capital stock is small compared with the real value of its net assets.

6. The law purports to tax the plaintiff's income received from March 1, 1913, to October 3, 1913, which necessarily has been expended or merged in its general assets prior to the passage of the act (Rec., p. 12).

POINT FIRST.

The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the states in its application to a general and uniform tax upon incomes from whatever source derived. The Income Tax Law of 1913, except insofar as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.

Our views in regard to the scope and meaning of the Sixteenth Amendment in the light of its history are presented in the First Point of our brief in *Brushaber* vs. *Union Pacific Railroad Company*, No. 140 on this calendar, to which, in order to avoid repetition, we beg leave to refer.

POINT SECOND.

So much of Section 2 of the Act of October 3rd, 1913, as limits the interest which may be deducted in ascertaining the taxable income of a corporation, to the interest accrued and paid within the year, upon an amount of indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock, is invalid.

The most important question presented by this case of *Tyee Realty Company* vs. *Collector* arises

out of the fact that by the necessary operation of the Income Tax Law the plaintiff is not taxed on its net income but upon a fictitious income created for the purpose of taxation only by the application of artificial rules of computation.

The plaintiff has an authorized capital stock of $10,000. It owns real estate in New York City subject to mortgage indebtedness aggregating $270,000. In 1913 it paid $13,750 as interest upon its mortgage debt. Its actual net income after deducting the interest thus paid, its taxes and other expenses, was $564.26. Upon this its normal tax would amount to $5.64. The tax actually exacted from the plaintiff was $70.64, being based upon a fictitious income of $7,064, which was computed for the purpose of taxation only by applying the limitation embodied in the statute. The reason for the excessive assessment was the provision of the statute which forbids a corporation to deduct from its gross income more than " the amount of interest accrued and paid within the year on its indebtedness not exceeding one half of the sum of its interest bearing indebtedness and its paid up capital stock outstanding at the close of the year." An individual income taxpayer is allowed to deduct from his gross income all interest actually paid during the year upon his indebtedness.

This one instance suffices to show that the present law does not in all cases tax net income. If it had not specified the deductions to be allowed from gross income, there is no doubt that the plaintiff would have been able to deduct from its gross income the amount of interest paid on its indebtedness in full. But as the law specified the deductions and forbids the corporation from making the present deduction, the result is a tax upon the corporation's gross income to a degree instead of its net income.

The discrimination is unwarranted by the Sixteenth Amendment.

The Sixteenth Amendment confers power upon Congress only to tax incomes from whatever source derived. This power necessarily is limited to the taxation of net incomes. Gross income or receipts not diminished by the outgoes of the period taken are not incomes in a true sense. Such amounts are greater than the income or the net income of the taxpayer. It is obvious that if a corporation in computing its income for the purpose of taxation is not allowed to deduct all interest paid upon all of its indebtedness during the period of computation, its taxation will be not of income or of net income but of its gross income, diminished to be sure, by some deductions but not by all of the deductions that would bring it down to income or net income. There is therefore from the operation of the statute a clear discrimination or classification made between corporations which have either no indebtedness, or indebtedness one-half of which does not exceed the par value of their capital stocks, and are therefore taxed upon their incomes or net incomes and corporations which by reason of the smallness of their capital stock in comparison with one-half of their indebtedness, are taxed upon their gross incomes, partially diminished but not so far diminished as to be income or net income. This discrimination or classification is unreasonable, and is founded upon no reason that bears a just relation to the subject matter, for a difference in the amount of the indebtedness of corporations furnishes no real distinction between them for purposes of classification for taxation.

This part of the statute can be declared invalid without affecting the scheme of taxation as a whole with the result that all corporations can remain in the same class of being taxed upon their actual in-

come. It is also obvious that the effect of that part of the statute here complained of is to discriminate against the corporations thus regulated in favor of individuals who are permitted to deduct the interest upon all their indebtedness in arriving at their net incomes.

It is our contention that the discrimination herein complained of is unconstitutional and void for the following reasons:

(1) The tax imposed by the statute in so far as it exceeds the normal tax of one per centum upon the actual net income of the plaintiff, being directly based upon the returns from the plaintiff's real property is a direct tax and and yet not an income tax within the meaning of the Sixteenth Amendment; consequently it is void for lack of apportionment.

(2) The classification upon which the discrimination is based is so arbitrary and unreasonable as to involve the taking of the property of the plaintiff without due process of law.

(3) The classification upon which the discrimination is based turns upon differences having no relation to any matter within the jurisdiction or control of Congress. Our argument under this latter proposition is presented in the second point of our brief in *Brushaber* vs. *Union Pacific Railroad Company*, No. 140 on the present Calendar, to which, in order to avoid repetition, we beg leave to refer.

The tax does not rest upon income in the true sense of the word.

The necessary result of this statute is that any corporation whose capital stock is exceeded by one-

half of its mortgage indebtedness, pays to some extent a tax upon its gross income instead of its net income. Such a statute does not impose an income tax within the meaning of the Sixteenth Amendment. The amendment, allowed a tax "on incomes from whatever source derived." This provision must be read in the light of history and precedent. Judged by them, there is no such thing as an income tax unless it is a tax upon net income. Gross income is not income in any sense of the word. It is not an object of taxation, and never was in any civilized government. Any Statute providing for an income tax, of necessity means a tax upon net incomes.

The Sixteenth Amendment authorizes a direct tax without apportionment only in so far as that tax is on income. Any direct tax beyond this must still be apportioned.

But to tax as income an amount which is made up of the sum of what is really income in its accepted sense, plus interest paid by a corporation on its indebtedness, is taxing the corporation's property that has produced this interest on its indebtedness which interest, although part of gross income, is outgo and not "income," and this clearly unauthorized under the Amendment. This is not a question of the intention of Congress but of the intention evidenced in the Sixteenth Amendment by the use of the word "income". It would have been easy, were such the purpose, entirely to abrogate the constitutional provision that direct taxes be apportioned. But the fact that a word of limited meaning has been used, added to the fact that the constitutional provision in regard to apportionment is an important safeguard and restriction on Congress, must lead to the conclusion that the abrogation was intended to be limited to a tax on income in the accepted sense of that word.

There can be no reasonable doubt as to the accepted meaning of the word "income."

In *Thompson* v. *Redding* [1897], 1 Ch. 876, at 879, the Court said:

> "What is 'income derived from them'? It appears to me that it is not the whole income which would be derived from these leaseholds without any deduction, but the income after making proper deductions in respect to these charges. 'Income derived', in ordinary parlance, is construed to mean, not the gross rents, but the rents after deducting all proper outgoings."

The cases in this country are to the same effect.

In *Peck* v. *Kinney*, 143 Fed. 76, the Circuit Court of Appeals of the Second Circuit in a case involving taxation under the War Revenue Act of June 13, 1898, at page 80 said:

> "There is this distinction between income and an annuity. The former embraces only the net profits after deducting all necessary expenses and charges; the latter is a fixed amount directed to be paid absolutely and without contingency."

In an opinion rendered the House of Representatives of the Commonwealth of Massachusetts (46 Mass. 596) the Justices (among whom was Mr. Chief Justice LEMUEL SHAW), at 598 said:

> "We are not quite certain that we understand precisely what is intended by the 'gross income' of the corporation, and what by the 'net income'. But we suppose that in any mode of estimating the income of the corporation, the expenses of the necessary repairs, and also of maintaining and employing engines and cars, for the carriage of passengers and freight, and all other necessary and incidental expenses of management, must be deducted from the actual receipts. *Such balance only can be regarded as the income of the corporation.*"

In *Poland* v. *Railroad Co.*, 52 Vt. 144, the Court at 177 said:

> "Income means what is left after paying the expenses of earning income."

In *Andrews* v. *Boyd*, 5 Me. 199, the Court at page 203 said:

> "The income of an estate means nothing more than the profit it will yield after deducting the charges of management, or the rent which may be obtained for the use of it. *The rents and profits of an estate, the income, or the net income of it, are all equivalent expressions.*"

The same proposition has been established by a series of decisions of the English and Canadian courts, which was familiar to American lawyers long prior to the adoption of the Sixteenth Amendment.

Lawless v. *Sullivan* (L. R., 6 App. Cas. 373);

City of Kingston v. *Canada Life Assurance Co.* (19 Ont. 453);

Taxation Commissioners v. *Antill* (L. R., 1902 App. Cas. 422).

In *Lawless* v. *Sullivan* (*supra*), the Privy Council, speaking through SIR MONTAGUE E. SMITH, said:

> "There can be no doubt that, in the natural and ordinary meaning of language, the income of a bank or trade for any given year would be understood to be the gain, if any, resulting from the balance of the profits and losses of the business in that year. That alone is the income which a commercial business produces, and the proprietor can receive from it. The question is, whether the word 'income' in the enactment to be construed is to be understood in a different, and what, for the purpose of taxation, would be a more onerous sense. It was not and could not be contended on behalf of the assessors that 'in-

come' in the enactment meant all the takings or moneys received by a bank or in a trade from customers or otherwise; and it was not denied that it meant profits, in some sense of the word. The contention, as their Lordships understood it, was that the items of profit should be selected from the accounts, and the aggregate of these items treated as being the income of the year. * * * The intention of the Legislature should be very clearly shown to justify an interpretation of the word 'income' which would require that, in the account for the year, the items of profit only should be included, and the losses excluded, although, but for the operations which occasioned the losses, the apparent profits could not have been made."

Lawless v. *Sullivan* (L. R. 6 App. Cas. 373, 378, 9).

In *City of Kingston* vs. *Canadian Life Assurance Company* (*supra*) the income tax law of the Province of Ontario imposed simply a tax upon income. The Court followed *Lawless* v. *Sullivan* (*supra*), holding that by that the Legislature intended only a tax upon net income. CHANCELLOR BOYD said:

"The matter of the taxation of corporations has arisen and is receiving very special attention in the different States of the adjoining republic, and in many of them the system of levying taxes on gross receipts for premiums and other like sources of income has been adopted. Our statute does not make any plain distinction between income tax properly so-called and a rate levied upon personal property though these are becoming badly contrasted by social economists. The assessments here imposed were in respect of income only and not in respect of personal property or of income and personal property. The distinction is, I think, material in view of the application of the Statute as it is framed 'Income' is not perhaps the most appropriate word to use with reference to corporations, but,

being used for convenience or for comprehensiveness, it must receive the same meaning which 'income' has in connection with individuals or partnerships." (Then the court after discussing *Lawless* v. *Sullivan* (*supra*) continues): "The judgment, then, is definite and conclusive upon this point, that 'income' as commercially used, means the balance of gain over loss in the fiscal year or other period of computation * * * I see nothing to detract from the ordinary commercial meaning attributable to the word 'income' as defined by the highest appellate tribunal of this country."

City of Kingston v. *Canadian Life Assurance Company* (19 Ont. 453, 457–8).

In the words of LORD MACNAGHTEN, the English Income Tax Law has this meaning alone: It never imposes a tax upon property. "It is as a source of income that the Act contemplates and deals with property" (*Colquhoun* v. *Brooks*, L. R. 14 A. C. 493, 516).

This distinction is further emphasized by the Privy Council in *Taxation Commissioners* v. *Antill* (*supra*). There an Australian statute imposed two taxes, a land tax and an income tax. The question was whether as to income, the respondent could deduct the fair value of land owned by him. The statute allowed certain deductions as to land values and this was not one of them. It was held that the deduction was not allowable, but it was intimated that if this had been an income tax, the question of deduction would be material as bearing upon the net income. LORD MACNAGHTEN said:

"Instead of collecting income tax by separate returns under different schedules of charge, as is the case under the income tax code in force in this country, the Act of 1895 in force in New South Wales first imposes a land tax upon all lands in the state with certain exceptions and then requires inclusive returns of all

> income arising from any property in the state except from land subject to land tax."
>
> *Taxation Commissioners* v. *Antill* (1902 App. Cas. 422, 428).

The only case that can be found where "income" was allowed to mean gross income, is *People* v. *Supervisors* (4 Hill 20), but there the statute imposed a tax upon a corporation 's capital stock. The tax was laid on all corporations "deriving an income *or* profit from their capital or otherwise." "Income," being set off against "profit," was construed as meaning gross income, as distinct from profit which meant net income.

Instances of taxes on gross receipts are common, but they are not and never have been called income taxes. Examples of such taxes have been before this court many times in cases ranging from *State Tax on Railway Gross Receipts* (15 Wall. 284) through *Philadelphia Steamship Company* v. *Pennsylvania* (122 U. S. 326) to *Maine* v. *Grand Trunk Railway* (142 U. S. 217). But as CHANCELLOR BOYD pointed out in the Canadian case above cited, such a tax as that is not an income tax and belongs in quite a different category. The so-called income tax laws imposed by Congress during the Civil War, it is true, allowed only certain deductions much in the manner of the present statute. But these statutes are not instructive from the present view point. This court solemnly determined that they did not impose an income tax on a holder of stocks or bonds of the corporation upon which the tax was laid, "but on the earnings of the corporations which pay the interest" (*Railroad Company* v. *Collector*, 100 U. S. 595). In *Little Miami Railroad* v. *United States* (108 U. S. 277) this court determined that the tax was imposed upon the profits of companies, and that

these profits meant "profits of the company in its business as a whole, that is to say, the excess of the aggregate of gains from all sources, over the aggregate of losses." Later this court held that the tax thus laid was an excise tax upon the business conducted by the corporation, and not a tax upon the bondholder or stockholder (*United States* v. *Erie Railroad Company*, 166 U. S. 327).

The Income Tax Law of 1894 forms no criterion, because it allowed as a deduction "the amount paid on account of interest, annuities and dividends." The Excise Tax Act of 1909 furnishes no criterion because it also allowed the deduction of indebtedness in full. It remained for the present act to make the distinction now complained of.

The classification is arbitrary and unreasonable.

To allow as deductions to individuals all interest paid within the year by such individuals on indebtedness, and to allow to certain corporations such a deduction, but to refuse the complete deduction to corporations one-half of whose indebtedness exceeds their authorized capital stock, constitutes against such corporations not only a taxing of what is not properly income but an arbitrary discrimination. Such exercise of taxing power transcends the constitutional limitations. For although one of the limitations upon the power of Congress has been abrogated by the Sixteenth Amendment so long as the subject taxed is income, nevertheless even within this subject, its powers are not without limit.

The idea of uniformity enters into the very definition of a tax. Cooley on Taxation, Third Edition, Volume 1, page 1, says:

> "Taxes are the enforced proportional contributions from persons and property levied by

> the state by virtue of its sovereignty for the support of the government and for all public needs."

And at page 4:

> "They differ from the enforced contributions, loans and benevolencies of arbitrary and tyrannical periods in that they are levied by authority of law and by some rule of proportion which is intended to insure uniformity of contribution and a just apportionment of the burdens of government."

Under our form of government this is an essential feature of taxation and constitutes a limitation upon the taxing power of Congress.

Gray, Limitations on Taxing Power, page 353:

> "The view established by authority is that the words as used in the Constitution refer to geographical uniformity. It is not intended by this to say that Congress can lay indirect taxes violative of all the principles of equality and uniformity as between persons. Congress *is* limited in this regard; but its limitations are derived not from the words 'uniform throughout the United States', but from the general nature of all legislative power to tax, from the inherent elements of uniformity and equality which partly make up the concepts of taxation and taxes. The restrictions upon Congress in this regard arise from the very nature of legislative power as a power held in trust for the whole people."

Cooley, Constitutional Limitations, pages 607, 615:

> "In the second place it is of the very essence of taxation that it be levied with equality and uniformity, and to this end that there should be some system of apportionment. Where the burden is common there should be a common contribution to discharge it. Taxation is the equivalent for the protection which the govern-

ment affords to the persons and property of its citizens; and as all are alike protected, so all alike should bear the burden. * * * Whatever may be the basis of taxation, the requirement that it shall be uniform is universal."

This principle has been many times recognized in this Court.

In *M'Culloch* v. *Maryland*, 4 Wheat. 316, Mr. Chief Justice MARSHALL at page 435 said:

> "The people of all the states and the states themselves are represented in Congress and by their representatives exercise this power. When they tax the chartered institutions of the states, they tax their constituents, *and these taxes must be uniform.*"

See also

Loan Assn. v. *Topeka*, 20 Wall. 655 at 663;
United States v. *Singer*, 15 Wall. 111 at 121;
Scholey v. *Rew*, 23 Wall. 331 at 348;
Ward v. *Maryland*, 12 Wall. 418 at 431.

In *Loughborough* v. *Blake*, 5 Wheat. 317, Mr. Chief Justice MARSHALL, speaking of the power of Congress to impose a direct tax within the District of Columbia, at page 325, said:

> "If it be said that the principle of uniformity established in the Constitution secures the District from oppression in the imposition of indirect taxes, it is not less true that the principle of apportionment also established in the Constitution secures the District from any oppressive exercise of power to lay and collect direct taxes."

In *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, it was contended that the statute was void for lack of uniformity. The Court, summarizing the contention, at page 555, said:

> "Under the second head it is contended that the rule of uniformity is violated in that the

> law taxes the income of certain corporations, companies and associations, no matter how created or organized, at a higher rate than the incomes of individuals or partnerships derived from precisely similar property or business; * * * these and other exemptions being alleged to be purely arbitrary and capricious justified by no public purpose and of such magnitude as to invalidate the entire enactment."

The Court, at page 586, stated that inasmuch as the Justices who heard the argument were equally divided upon the question whether the tax was invalid for want of uniformity, no opinion was expressed on that subject. Mr. Justice FIELD, however, in his concurring opinion, at page 594, said:

> "The object of this provision (of uniformity) was to prevent unjust discrimination. *It prevents property from being classified and taxed as classed by different rules.* All kinds of property must be taxed uniformly or be entirely exempt. The uniformity must be co-extensive with the territory to which the tax applies.
>
> Mr. Justice MILLER in his Lectures on the Constitution (N. Y. 1891) pages 240, 241, said of taxes levied by Congress: 'The tax must be uniform on the particular article; and it is uniform within the meaning of the constitutional requirement if it is made to bear the *same percentage* over all the United States. That is manifestly the meaning of this word as used in this clause. The framers of the Constitution could not have meant to say that the government in raising its revenues should not be allowed to discriminate between the articles which it should tax.' In discussing generally the requirement of uniformity found in state constitutions he said: 'The difficulties in the way of this construction have, however, been very largely obviated by the meaning of the word "uniform" which has been adopted holding that the uniformity must refer to articles

of the same class. *That is different articles may be taxed at different amounts provided the rate is uniform on the same class everywhere with all people and at all times.* * * *'

" Exemptions from the operation of a tax always create inequalities. Those not exempted must in the end bear an additional burden or pay more that their share. A law containing arbitrary exemptions can in no sense to termed uniform. * * * Where property is exempted from taxation the exemption, as has been justly stated, must be supported by some consideration that the public and not private interests will be advanced by it. Private corporations and private enterprises cannot be aided under the pretense that it is in the exercise of the discretion of the legislature to exempt them."

And further at page 596:

" Whenever a distinction is made in the burdens a law imposes or in the benefit it confers on any citizens by reason of their birth or wealth or religion, it is class legislation and leads inevitably to oppression and to general unrest and disturbance in society. It was hoped and believed that the great amendments to the Constitution which followed the late Civil War had rendered such legislation impossible for all future time."

And at page 599:

" There are other considerations against the law which are equally decisive. They relate to the uniformity and equality required in all taxation, national and state; * * *

" As stated by counsel, 'There is no such thing in the theory of our national government as unlimited power of taxation in Congress.' There are limitations as he justly observes, of its powers arising out of the essential nature of all free governments. There are reservations of individual rights without which society could

not exist and which are respected by every government. The right of taxation is subject to these limitations (citing cases).

"The inherent and fundamental nature and character of a tax is that of a contribution to the support of the government levied upon the principle of equal and uniform apportionment among the persons taxed and any other exaction does not come within the real definition of a tax.

"This inherent limitation upon the taxing power forbids the imposition of taxes which are unequal in their operation upon similar kinds of property and necessarily strikes down the gross and arbitrary distinctions in the income law as passed by Congress.

In *Southern Railway Company* v. *Greene*, 216 U. S. 400, it was held that a statute which classified separately domestic and foreign corporations for the purpose of taxation and imposed a greater franchise tax upon foreign corporations than that imposed upon domestic corporations was an arbitrary selection, and could not be justified by calling it classification in the absence of real distinction of a substantial basis. The Court said:

"While reasonable classification is permitted without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed, and cassification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified by calling it classification. (*Gulf, Colorado & Santa Fe Ry.* v. *Ellis*, 165 U. S. 150, 155, 165; *Cotting* v. *Kansas City Stockyards Co.*, 183 U. S. 79; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559.)"

While the case above cited arose under the Fourteenth Amendment to the Constitution of the United

States, and while it was held that the complaining corporation was a citizen within the jurisdiction of the State of Alabama and entitled to the equal protection of its laws under that amendment, the case is an additional authority to many in this Court upon the proposition that while a legislative body possesses great powers in classifying subjects of taxation and imposing different rates of taxation upon different classes of subjects, the action of the legislature must be classification and not arbitrary selection. It is well said that the object of the Fourteenth Amendment was "to prevent any person or class of persons from being singled out as a special subject for discrimination and hostile legislation" (*Pembina Mining Co.* v. *Pennsylvania*, 125 U. S. 181, 188), but the principle of the Fourteenth Amendment that prevents this discriminating and hostile legislation is found in the implied limitations of the Constitution of the United States upon the taxing power of Congress. The power that is given to Congress is to levy and collect taxes, and amounts sought to be collected by legislation by the process of arbitrary selection and not by that of classification are not taxes, but arbitrary exactions and beyond the power of Congress to enforce. It has been frequently held that, notwithstanding the language of the Fourteenth Amendment in its guarantee of equal protection of the laws is not to be found in the Constitution of the United States, that its principle is an implied limitation on the powers of Congress, and that the Constitution of the United States by implication requires Congress to see to it that in its legislation the citizens of the United States receive the equal protection of the laws of the United States.

That this implied limitation on the power of Congress is transcended by decreeing that the amount of the tax be figured in one manner when levied upon an individual and in another when levied upon

a corporation whose indebtedness exceeds its authorized capital stock, is clear. To grant individuals a deduction for indebtedness but to deny such deduction to the same extent to corporations is capricious and arbitrary.

In *County of Santa Clara* v. *Southern Pacific R. Co.*, 18 Fed. 385 (aff'd 118 U. S. 394), Justice FIELD held that a tax law which discriminates between the assessment for taxation of the property of a corporation and of the property of individuals, giving individuals an exemption not granted to the corporation, was unconstitutional. The Act therein concerned declared that a mortgage, deed of trust, contract or other obligation should for the purposes of assessment and taxation be deemed an interest in the property affected thereby, and provided:

> "*Except as to railroad and other quasi public corporations* in case of debts so secured, the value of the property affected by such mortgage, deed of trust, contract or obligation, less the value of such security, shall be assessed and taxed to the owner of the property and the value of such security shall be assessed and taxed to the owner thereof."

Justice FIELD at page 394 said:

> "Instances of every day occurrence will show the effect of this discrimination in a clear light. A natural person and a railroad company own together a parcel of property in equal proportions subject to a mortgage. In estimating the value of the undivided half belonging to the natural person, half of the amount of the mortgage is deducted. In estimating the value of the undivided half belonging to the railroad company, no part of the mortgage is deducted. The discrimination is made against the company for no other reason than its ownership. * * * Every one sees that the valuation has not in fact changed with the ownership, and therefore that the discrimination is made solely

because a rule is adopted and the assessment of the property of one party different from that applied in the assessment of the property of the other, purely on account of its ownership. A corresponding difference in the tax which the different owners must pay follows the assessment. Thus, if two adjoining tracts are subject to a mortgage, each for half its value, the natural person owning one of them pays a tax on the other half, while the corporation must pay a tax on the whole of its tract; that is, double the tax of the individual. * * *

"The principle which sanctions the elimination of one element in assessing the value of property held by one party, and takes it into consideration in assessing the value of property held by another party, would sanction the assessment of the property of one at less than its value,—at a half or a quarter of it,—and the property of another at more than its value,—at double or treble of it,—according to the will or caprice of the state. To-day railroad companies are under its ban, and the discrimination is against their property. To-morrow it may be that other institutions will incur its displeasure. If the property of railroad companies may be thus sought out and subjected to discriminating taxation, so, at the will of the state, by a change of its constitution, may the property of churches, of universities, of asylums, of savings banks, of insurance companies, of rolling and flouring mill companies, of mining companies, indeed, of any corporate companies existing in the state. The principle which justified such a discrimination in assessment and taxation, where one of the owners is a railroad corporation and the other a natural person, would also sustain it where both owners are natural persons. A mere change in the state constitution would effect this if the federal constitution does not forbid it. Any difference between the owners, whether of age, color, race, or sex, which the state might designate, would be a sufficient reason for the discrimination. It would be a singular comment upon the weakness and character of our republican institutions if the

valuation and consequent taxation of property could vary according as the owner is white, or black, or yellow, or old, or young, or male, or female. A classification of values for taxation upon any such ground would be abhorrent to all notions of equality of right among men. Strangely, indeed, would the law sound in case it read that in the assessment and taxation of property a deduction should be made for the mortgages thereon if the property be owned by white men or by old men, and not deducted if owned by black men or by young men; deducted if owned by landsmen, not deducted if owned by sailors; deducted if owned by married men, not deducted if owned by bachelors; deducted if owned by men doing business alone, not deducted if owned by men doing business in partnerships or other associations; deducted if owned by trading corporations, not deducted if owned by churches or universities; and so on, making a discrimination whenever there was any difference in the character or pursuit or condition of the owner. To levy taxes upon a valuation of property thus made is of the very essence of tyranny, and has never been done except by bad governments in evil times, exercising arbitrary and despotic power."

When the case came before this Court (118 U. S. 394), the Court at page 410 stated that the importance of the constitutional questions could not well be over-estimated, but that they belonged to a class which the Court could not decide unless essential to the disposition of the case. The Court thereupon affirmed on the ground that the entire assessment was a nullity.

The same question was before this Court in *San Bernardino Co.* v. *Southern Pacific R. R. Co.*, 118 U. S. 417. Justice FIELD concurring, stated that he regretted that it had not been deemed consistent with the duty of the Court to decide the important

constitutional questions involved, and at page 422 stated:

> "At the present day nearly all great enterprises are conducted by corporations. Hardly an industry can be named that is not in some way promoted by them and a vast portion of the wealth of the country is in their hands. It is therefore of the greatest interest to them whether their property is subject to the same rules of assessment and taxation as like property of natural persons, or whether elements which affect the valuation of property are to be omitted from consideration when it is owned by them and considered when it is owned by natural persons; and thus the valuation of property be made to vary not according to its condition or use but according to its ownership. The question is not whether the state may not claim for grants or privileges and franchises a fixed sum per year or a percentage of earnings of a corporation—that is not controverted—but whether it may prescribe rules for the valuation of property for taxation which will vary according as it is held by individuals or by corporations. The question is of transcendent importance and it will come here and continue to come until it is authoritatively decided in harmony with the great constitutional amendment which insures to every person whatever his position or association, the equal protection of the laws; and that necessarily implies freedom from the imposition of unequal burdens under the same conditions."

In *County of San Mateo* v. *Southern Pacific R. Co.*, 13 Fed. 145, the case had been removed to the Federal Court, and the opinion was written on a motion to remand. Justice FIELD stated that the rule of equality necessitated by the Fourteenth Amendment had been recognized by Congress as applicable to Federal taxation, at page 150 saying:

> "Equality of protection is thus made the constitutional right of every person; and this

equality of protection implies not only that the same legal remedies shall be afforded to him for the prevention or redress of wrongs and the enforcement of rights, but also that he shall be subjected to no greater burdens or charges than such as are equally imposed upon all others under like circumstances. No one can, therefore, be arbitrarily taxed upon his property at a different rate from that imposed upon similar property of others, similarly situated, and thus made to bear an unequal share of the public burdens. Property may indeed be classified, and different kinds be subjected to different rates. Real property may be taxed at one rate and personal property at another. Property in particular places may be taxed for local purposes, while property situated elsewhere is exempt. License taxes may also vary in amount, according to the calling or business for which they are exacted. But arbitrary distinctions not arising from real differences in the character or situation of the property, or which do not operate alike upon all property of the same kind similarly situated, are forbidden by the amendment. Equality in the imposition of burdens is the constitutional rule as applied to the property of individuals, where it is subject to taxation at all; and this imports that an uniform mode shall be followed in the estimate of its value, and that the contribution exacted shall be in some uniform proportion to such value prescribed, according to the nature or position of the property. All state action, constitutional or legislative, impinging upon the enforcement of this rule, must give way before it. Congress, in its legislation since the adoption of the amendment, has recognized this to be the rule The amendment was adopted in 1868, and in 1870 Congress re-enacted the Civil Rights Act; and to the clause that all persons within the jurisdiction of the United States should enjoy the same rights as white citizens, and be subject only to like punishment, pains, and penalties, it added: and be subject only to

like '*taxes, licenses, and exactions of every kind, and to no other.*' Rev. St. Sec. 1977."

See also *Northern Pac. R. Co.* v. *Walker*, 47 Fed. 681, at 685.

Conclusion.

The provision complained of prohibits a corporation, one-half of whose indebtedness exceeds its authorized capital stock, from taking its net earnings as a basis of its taxation, and requires it to pay a tax based in part upon its gross receipts. Whatever necessity exists for such a requirement for the purpose of raising revenue, exists equally in the case of all other corporations and of individuals. The discrimination has nothing to do with the production of revenue and cannot be justified on that ground. If a corporation, one-half of whose indebtedness exceeds its capitalization, is to be taxed upon its gross receipts, while a corporation not in such position is taxed upon its net income, the result is a punishment by Congress of the companies whose gross revenues are taxed. Such punishment can only be escaped by increasing their authorized capitalization, in order that the taxation may be confined to their net revenue. The inevitable tendency of this system is to so burden corporations whose authorized capital stock is not adjusted to their indebtedness according to the plan prescribed, that they must conform thereto in order to escape the burden, regardless of the public policy of the State which created them.

According to the same method and principle Congress, might proceed to regulate by taxation any feature of corporate organization or management over which it might choose to assume control. This plaintiff is subjected to a twelve-fold tax, because its capital stock is small as compared with its bonded debt. If that exercise of legislative power is approved we may soon see laws to the effect that cor-

porations having seven directors are to pay a normal tax on their net income only, while corporations having more or less than seven directors are to pay a tax based in part on their gross receipts; or that corporations which do not permit cumulative voting for directors are to be taxed at a greater rate than those that do. We may see tax laws designed to regulate the relative amount of preferred stock issued and the rate of dividends thereon; we may see restrictions on corporate expenses, on officers' salaries and even on the personal habits of officers and members of corporations, all taking the form of discriminating taxes on income. Unless the distinction between legitimate and arbitrary classification is to be drawn at a point so clearly marked as that which appears in the facts of this case, there is no limit to the extent to which Congress may interfere not only with the internal affairs of corporations engaged in business wholly subject to State jurisdiction, but even with the private and personal affairs of the members and directors of such corporations.

POINT THIRD.

The statute is invalid in the particular of seeking to tax income received prior to October 3rd, 1913, and the tax complained of is wholly void because based in part upon such income.

The complaint alleges (Rec., p. 6):

> "The tax assessed against the plaintiff as aforesaid did not purport to be based upon any income received or accrued after the approval of said Act, but purported to be and in fact was

> based upon the amount shown by the return of the plaintiff as its net income for the entire year ending December 31, 1913, of which said net income a large amount actually accrued to and was received by the plaintiff prior to October 3rd, 1913. At the time of the assessment of the said tax there was no competent evidence before the Commissioner of Internal Revenue that any income had accrued to or had been received by the plaintiff on or subsequent to October 3rd, 1913."

The rents and profits received by the plaintiff from its real property prior to October 3rd, 1913, were not on that day "income" in such a sense that they could be taxed by Congress under the authority of the Sixteenth Amendment. Our argument upon this subject is presented in the fourth point of our brief in *Brushaber* vs. *Union Pacific Railroad Company*, No. 140 on this Calendar, to which in order to avoid repetition we beg leave to to refer.

It cannot be contended that any part of the tax assessed against the plaintiff for the year 1913 was authorized by Section 38 of the Act of August 5, 1909, commonly called the "Corporation Tax Law," for the reason that so much of said section as authorized the making of any assessment upon the income of corporations after March 1st, 1913, was expressly repealed by Subdivision S of Section III of said act.

Furthermore, the plaintiff is not engaged in any business other than the receipt and distribution of the rents of its real property. The complaint expressly alleges (Rec., p. 3):

> "The business for which the plaintiff was organized and the only business which the plaintiff has ever conducted is the holding for investment of real property in the State of New York."

The mere receipt of income is not business upon which an excise tax can be levied, otherwise it would have been necessary for this Court to sustain the Income Tax Law of 1894 in its entirety as an excise tax. Accordingly, it was held by this Court in *McCoach* v. *Minehill Ry. Co.*, 228 U. S. 292, and in *Zonne* v. *Minneapolis Syndicate*, 220 U. S., 187, that corporations situated as this plaintiff is, having no other function than the receipt and distribution of rentals, were not subject to taxation under the Act of 1909.

The result of including in the assessment the income of this plaintiff prior to October 3, 1913, is to make the whole tax void. Our argument upon this subject is presented in the fifth point of our brief in *Brushaber* v. *Union Pacific Ry. Co.*, No. 140 on this Calendar, to which in order to avoid repetition we beg to refer.

POINT FOURTH.

The judgment should be reversed and the demurrer overruled, with leave to the defendant to answer.

Dated September 18, 1915.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Martin A. Schenck

Of Counsel.